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RR RUEHLMC
DE RUEHSN #1484/01 2132250
ZNR UUUUU ZZH
R 012250Z AUG 07
FM AMEMBASSY SAN SALVADOR
TO RUEHC/SECSTATE WASHDC 7197
INFO RUEHZA/WHA CENTRAL AMERICAN COLLECTIVE
RUCPDOC/USDOC WASHDC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHINGTON DC
RUEHRC/USDA FAS WASHDC

UNCLAS SECTION 01 OF 03 SAN SALVADOR 001484

SIPDIS

STATE PASS USAID/LAC
STATE ALSO PASS USTR
USDOC FOR 4332/ITA/MAC/WH/MSIEGELMAN
3134/ITA/USFCS/OIO/WH/PKESHISHIAN/BARTHUR
SIPDIS

E.O. 12958: N/A
TAGS: ECON ETRD EINV ES
SUBJECT: CAFTA-DR FIRST YEAR IMPACT ON TRADE

REF: A. SAN SALVADOR 453, B. SAN SALVADOR 2513, C. SAN SALVADOR

2475, D. SAN SALVADOR 1185, E. SAN SALVADOR 1183.

Summary

¶1. The one year results on CAFTA-DR are very positive. Total nonmaquila exports increased by 59.1 percent during the first year of CAFTA-DR, rising from $266 million in March 2006 to $423 million by February 2007. Though ethanol exports accounted for 88.1% of this increase, other sectors also enjoyed significant export growth. Due chiefly to Chinese and regional competition, exports in the large maquila sector fell by 11%. As a result, total Salvadoran exports to the United States fell slightly (by 1.5%) during the first year of CAFTA-DR. While clearly presenting opportunities, CAFTA-DR will not be the success it can be unless El Salvador resolves its severe crime problem. In addition to increased trade, the other benefits of CAFTA-DR, such as good governance and business practices, could have the greatest impact on El Salvador in the long run. End summary.

Salvadoran Ethanol Exports Expand Most

¶2. Nonmaquila exports (which do not include apparel manufactured for export in a free trade zone using mostly imported components) increased by 59.1% during the first year of CAFTA-DR, which entered into force for El Salvador on March 1, 2006. From March 2006 through February 2007, nonmaquila exports increased from $266 million to $422.5 million. Ethyl alcohol (ethanol) accounted for 88.1% of the increase. Exports of ethanol grew from $34 million to $173 million, a 402% increase in one year. (Comment. Much of the ethanol that is exported to the United States comes from Brazil and is dehydrated to qualify for duty free export. Reftel B describes Salvadoran ethanol production capacity and plans for expansion. End comment.) Excluding ethanol, nonmaquila exports to the U.S. grew by 8.1% in the first year of CAFTA-DR (from $231.2 million to $250 million).

¶3. According to the Central Bank, total Salvadoran exports to the United States in the period fell by 1.5% (from $1.97 billion to $1.94 billion). An 11% decline in maquila exports, from $1.7 billion to $1.5 billion, offset the significant increase in other nontraditional exports. Maquila exports fell mainly due to the increased Chinese and regional competition (see reftel C for more information about the textile and apparel industry).

Other Salvadoran Exporters Also Benefit

¶4. Though on a smaller scale than ethanol exporters, other exporters

have taken advantage of the permanent benefits provided by CAFTA-DR, especially those exporting to the Salvadoran ethnic market in the United States. During the first year of CAFTA-DR, dairy exports more than tripled, growing from $262 thousand to $814 thousand. Cheese varieties aimed at the ethnic market accounted for most of the increase. Packaged and prepared fruits and vegetables increased by almost 50% from $2.2 million to $3.2 million. Exports of cookies, pastries and other prepared foods grew from $4.9 million to $6.4 million (a 31% increase). Exports of other ethnic related products, including a variety of prepared foods, herbs, spices and local fruits, have also increased. Seafood exports to the United States grew by 17%, to $25 million. Most of this increase was concentrated in the exports of prawns which grew by 36%, and to a lesser extent in the exports of small salted shrimps, which increased by 27%. The latter are aimed to the Salvadoran ethnic market in the U.S. for the production of Salvadoran style shrimp cocktails.

¶5. Exports of apparel, especially cotton t-shirts and dresses, showed a notable increase under CAFTA-DR, growing from $21.5 million to $33.7 million, a 28.9% increase. Towel exports grew by 36%, to $9.6 million. Exports of synthetic fibers more than tripled, growing from $1.2 million to $3.7 million.

¶6. Light manufacturing also showed positive results. In the first year of CAFTA-DR, electrical machinery exports to the United States increased by 85%, from $3.7 to $7.1 million. The Mexican-Japanese joint venture firm Arnecom accounted for most of this increase by exporting $4.7 million of automobile wiring harnesses during the first year of CAFTA-DR. Exports of toys and decorations also increased, by 51% to $1 million.

U.S. Gains

¶7. The Central Bank reported that U.S. exports to El Salvador grew

by 6.4% during the first year of CAFTA-DR, from $2.9 billion to $3 billion. Though U.S. exports of maquila inputs decreased by 13%, from $1.3 billion to $1.1 billion, nonmaquila exports significantly increased. U.S. nonmaquila exports to El Salvador grew by 22.7%, to $1.9 billion. U.S. pork exports multiplied almost 7 times, from $240 thousand to $1.6 million. (Note. Total national pork consumption has risen since CAFTA-DR entered into force. The local pork association - ASPORC - said U.S. pork imports have also stimulated more and better quality local pork production. ASPORC said consumers are also benefiting from the wider variety of pork products available. End note.) Rice exports to El Salvador increased by 19.6%, from $18.7 million to $22.4 million. U.S. white-corn exports increased 24%, from $11.7 million to $14.5 million and U.S. yellow corn exports were up 32%, to $70 million. Though, El Salvador is blocking the entry of U.S. poultry and eggs, an issue which is being addressed on several levels with the GOES.

¶8. U.S. exports of aluminum, sweeteners, shoes, steel and iron products, prepared/processed fruits and vegetables, and precious metals/jewelry experienced growth rates of over 50%. Motors and electronics exports to El Salvador were up 43%, from $180 million to $257 million.

Creating Jobs and Spurring Reform

¶9. In June, on the third anniversary of his administration, President Saca noted that during his term El Salvador has attracted 96 new foreign businesses, directly creating 18 thousand jobs (reftel D). CAFTA-DR and sound economic policies put El Salvador on the investment map. The GOES is committed to making it easier to do business in El Salvador, for instance through streamlined administrative procedures designed to make it easier to start a business. The GOES is also looking to update its civil and commercial codes to further improve the investment climate. These efforts are paying off. In 2006, El Salvador's economy grew by 4.2%, the highest in a decade, with GDP growth projected to be 4.5% in 2007.

Comment

¶10. It is worth noting again that CAFTA-DR is neither a quick fix nor a complete solution to El Salvador's poverty and sustainable development issues. CAFTA-DR will not fulfill its promise unless other issues are adequately addressed by the Salvadorans. First and foremost, the severe problem of violent crime must be resolved. The highest homicide rate in the hemisphere and 30,000 gang members in the country are clear deterrents to investment, foreign and domestic. We are working closely with the GOES on its efforts to take back its streets and there is some progress. El Salvador must also find a way to end the political polarization in the country. Uncertainty about the future direction of the country continues to impede investment. The three year election cycle (five for the president) means that an election is always just around the corner (the next in early 2009) and with it concerns that a FMLN government might be elected that would dismantle CAFTA-DR, dollarization and other sustainable economic policies. Security problems make it easier for the FMLN to convince the public that a regime change is needed.

¶11. CAFTA-DR has had a positive impact and the Salvadoran economy appears to be headed in the right direction. Even in these early stages, CAFTA-DR is providing opportunities for greater participation in the global market. While ethanol exports have expanded the most, other exporters (Salvadoran and U.S.) have benefited from CAFTA-DR. Perhaps the clearest example for Salvadoran exports is the ethnic food market opportunities in the United States.

¶12. The less tangible benefits that CAFTA-DR and sound GOES economic policies have had on good governance and transparency should not be ignored when we calculate the impact of CAFTA-DR. These policies attract U.S. companies like Dell to the country. They in turn bring U.S. style management and business practices; where, for instance, exceptional employees are promoted within the company and not stuck in place where they might be in a traditional family-owned enterprise. (See reftel E for Dell's many contributions to El Salvador.) In the long run, some of these intangibles may prove to be CAFTA-DR's most important contribution to El Salvador's economic development. El Salvador still works under a 'who you know' is more important than 'what you know' principle, but this is slowly changing. Increased development of sound business practices and good governance, as promoted under CAFTA-DR, will be essential long term drivers of sustained growth in El Salvador.

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